Employee Share Ownership and Performance: Commitment or Entrapment?

Sukanya Sengupta*, Andrew Pendleton **, Keith Whitfield ***

*Cardiff Business School, Cardiff University, senguptas@cardiff.ac.uk

**York Management School, University of York, ap516@york.ac.uk

***Cardiff Business School, Cardiff University, whitfield@cardiff.ac.uk

INTRODUCTION

Recent years have seen the advent of a wide range of worker-focused holistic approaches by firms in search of improved competitive performance in their product markets (Appelbaum and Batt, 1994; Paauwe, 2004; Whitfield and Poole, 1997). Amongst these practices, employee share-ownership (ESO) has been accorded a pivotal role in this process. It is seen by many as encouraging employees to identify more closely with their employing organisation, taking on board its values more fully, and thereby making a stronger contribution to its continued development. (Blasi et al., 2003; Conte and Svejnar, 1988; Klein, 1983).

While there is strong evidence to suggest that ESO schemes are associated with higher performance in organisations (Fernie and Metcalf 1995; Long 1978b; McNabb and Whitfield 1998; Pendleton 1997; Sengupta 2008) there is a lack of theoretical understanding as to the precise mechanisms through which these schemes generate value. The widely held perception is the “golden path” approach which suggests that the ESO schemes have their main impact upon performance through affective commitment (employee’s emotional attachment to, identification with and involvement in the organisation). The alternative view suggests that share ownership schemes are primarily an effective worker retention tool, and reduce labour turnover by making it financially lucrative for workers to remain in the firm and financially expensive for workers to leave it (Marsden 1999; Morris et al. 2006) – the “golden handcuffs” hypothesis.

More recently a nationally representative study (Sengupta et al. 2007), drawing on the 1998 Workplace Employee Relations Survey (WERS98), challenged the dominant view by suggesting that while ESO schemes had a positive impact upon performance, the intermediate mechanism seemed to be lower employee turnover rather than higher affective commitment. This study clearly addresses important methodological constraints evident in previous research on ESO and performance, by drawing on a representative sample. However, Pendleton (2007) pointed out that these results should be further validated by using a more stringent measure of ESO schemes to that provided by the WERS 98 dataset. Pendleton (2007) argued that the generalised wording of the question on ESO presence in the WERS 98 dataset may cause problems of validity and reliability since a generic definition may include schemes that are not strictly share-ownership schemes and hence, may downwardly bias estimates of share plan presence. Also a generic question on ESO schemes does not capture the heterogeneity of these schemes despite the suggestion that different types of schemes are likely have varied performance outcomes (Fernie and Metcalf 1995). Therefore, using specific questions that are more tailored to the types of share plans allows more precise and more reliable analysis of the presence of share ownership plans generally as well as facilitating cross-temporal investigations of particular plans (Pendleton 59:2007). The WERS 2004 dataset provides data on specific named share ownership plans.

Therefore, the current paper investigates the mechanisms linking ESO schemes to performance using the new measure for ESO schemes by drawing on the WERS 2004 dataset. It can be expected that a more refined measure of ESO schemes in WERS 2004 dataset will provide a stronger test of the causal mechanisms linking ESO schemes to organisational performance. In so doing, it attempts to validate the findings based on the WERS 98 dataset that advocated the golden handcuff thesis rather than golden path thesis in explaining the mechanisms linking ESO schemes and performance (Sengupta et al. 2007). Overall, thispaper endeavours to refine the analysis and advance the ongoing debate on whether different types of ESO schemes are likely to impact upon performance by enhancing affective commitment or lowering employee turnover.

BACKGROUND

Theoretical workon the relationship between share-ownership and performance has been extremely limited (Guest, 1997). Furthermore, how precisely this alignment of interests happens in practice, is a subject of much debate. One explanation of the potential role of share-ownership in promoting firm performance is that workers owning capital in their firms become more committed to its goals and values. Long (1978a), for example, postulates that share-ownership increases organisational identification, which in turn has a positive impact upon firm performance. Therefore, one would expect workers in firms operating share-ownership schemes to exhibit a greater commitment to the firm and its values. This could, in turn, be expected to yield a higher level of work effort and a greater willingness to undertake activities that are in the firm's interests, while not necessarily being in the worker's own immediate self-interest. This yields ***hypothesis one, which states that employees in firms operating employee share-ownership schemes will exhibit higher levels of commitment to the values of their organisation, other things equal.***

An alternative view of the share-ownership/performance relationship is, however, sceptical of such a golden path involving enhanced commitment. This approach suggests that share-ownership schemes are primarily an effective worker retention tool, and reduce labour turnover by making it financially lucrative for workers to remain in the firm and financially expensive for workers to leave it (Marsden 1999; Morris et al. 2006) – the "golden handcuffs hypothesis". In the presence of specific human capital, this can yield a turnover rate that is closer to the firm's optimum, thereby economising on a mix of hiring and firing and training costs (Blair and Kruse, 1999; Richardson and Nejad, 1986). ***This yields the second hypothesis that share-ownership firms will have lower turnover rates, other things equal.***

It is widely argued that lower levels of employee turnover, in turn, often encourage greater firm-specific capital investment which contributes towards greater labour productivity and subsequently higher financial performance (Lincoln and Kalleberg, 2003; Richardson and Nejad, 1986). To the extent that it is effective, one would anticipate that the positive relationship between share-ownership and performance would be lower in analyses where the impact of turnover had been allowed for, reflecting the mediating influence of the latter. ***This yields the third hypothesis that part of any positive association between share-ownership and performance can be attributed to a negative impact of share-ownership on labour turnover.***

Previous empirical work on the relationship between share-ownership and commitment were largely inconclusive. The results range from reporting higher commitment levels (Long, 1978; Pendleton, 2001), to lower commitment levels (Kruse, 1984) and some showing no difference in the levels of commitment (French and Rosenstein, 1984; Sengupta et al. 2007) in ESO workplaces. The inconclusive findings could be attributable to a host of reasons ranging from the measures of share-ownership and commitment to the lack of generalisability of findings because of a tendency to rely on small sample sizes. The few studies that have investigated the effect of ESO schemes on employee turnover are more consistent in that they report an inverse relationship between the presence of these schemes and employee turnover (Wilson et al., 1990). The only study that has attempted to test the causal mechanisms linking ESO schemes and performance by drawing on a nationally representative sample provided support for the golden handcuff hypothesis and challenged the golden path hypothesis (Sengupta et al. 2007). The validity of these findings was challenged recently owing to the fact that the WERS 98 dataset provides a very generic measure for ESO schemes (Pendleton 2007). A generic measure often include schemes that are not strictly employee share ownership schemes thus diluting the effect of ESO schemes on performance. In addition, using a generic measure for ESO does not allow for testing the relative effects of different types of ESO schemes on performance. While it is widely accepted that the different types of schemes will have varying impact upon the share ownership performance relationship (Fernie and Metcalf; Addison and Belfield 2001), there is no consensus as to how the different types of schemes affect the performance outcomes.

There is debate about whether broad-based stock option plans (SAYE, SIP) have a more beneficial effect on performance or the narrow based stock option plans (CSOPs and EMI). One view is that broad-based stock option schemes typically allocates a small equity stake to a large number of employees thereby aligning the interests of a majority of employees to that of the organisation. Consequently they are likely to have a stronger impact upon organisational performance in comparison to narrow stock option plans which include a small proportion of the managerial employees. However, using the expectancy theory it could be argued that the narrow based schemes are likely to be more effective than the broad based schemes. Expectancy theory postulates that for financial participation schemes to have the desired benefits two conditions should be in place i.e. the employees should value the reward offered by these schemes and they should see a clear connection between their efforts, their rewards and the organisational performance. In case of narrow based schemes like CSOPs these conditions are satisfied. First, there is a lucrative financial reward which can be upto a value of £30,000. Second, it is generally offered to top executives who have a greater say in the strategic decisions than non-managerial employees and can make a significant contribution to organisational success. Therefore, these share-owners can see a clear link between their efforts and the financial rewards and are more likely to put in greater effort which would translate into higher productivity, commitment and lower employee turnover. In contrast broad based ESO schemes like SAYE thinly distribute a small slice of the equity amongst a huge proportion of the employees who tend to have little or no say in the decision making process of the company. Hence, neither is the reward financially lucrative nor do the employees see a clear link between their efforts and their reward and organisational performance, consequently, these schemes may fail to elicit the desired response from the employees in terms of greater effort/higher labour productivity or lower employee turnover or higher levels of commitment. The evidence for this is mixed and ranges from higher performance benefits observed in case of narrow based executive stock option plans (Fernie and Metcalf 1995)and others showing higher performance benefits for broad based stock option plans (Addison and Belfield 2001). This issue merits further investigation and yields ***the fourth hypothesis which states that the narrow-based share option schemes such as CSOPs have differing effects upon performance outcomes relative to the more broad based share option schemes such as SAYE.***

METHODS

Data The analysis uses matched employer-employee information from the 2004 Workplace Employee Relations Survey (WERS2004). The WERS dataset provides comprehensive information on a nationally-representative sample of firms in Britain. We draw on data from two sources. First, is a Management Questionnaire based on face-to-face interviews with senior managers in 2,295 establishments (response rate 64%). Second is an Employee Questionnaire, which is a self-completion instrument distributed to a random sample of up to 25 employees in each workplace (response rate 60%). The matched employer-employee data comprises of 22,451 employees working in 1,733 workplaces employing 5 or more employees. Data on the establishments include information on their structural characteristics, management employment practices, product markets, labour force composition and the nature of their collective employment relations. That on employees includes weekly pay, occupational group, qualifications, marital status, age, gender, union membership, hours worked and tenure.

Performance Variables. In WERS2004, the measures of performance are qualitative, and are derived from manager assessments of what is happening in their own establishment relative to what they believe is happening in other establishments in the same industry. Two dimensions of performance are considered, financial performance and labour productivity. The variables used in the performance analyses are binary, taking the value "1" if the workplace has above average performance and "0" otherwise. Though WERS 2004 allows the option of using objective measures of performance the preference was to rely on the subjective performance measures for several reasons. First, several studies have validated the reliability of the subjective performance measures (Machin and Stewart 1996; Wall et al. 2004). Second, the objective performance measures were available for 1, 070 workplaces in comparison to the subjective performance measures that were available for 2,295 workplaces, thereby restricting the sample size considerable. Besides, the subjective measures are articulated as a useful alternative to objective performance measures which have limitations of their own (Machin and Stewart, 1996).

Commitment Variable. The commitment variable is based on a question asked in the employee questionnaire which seeks to determine the extent to which the respondent agrees or disagrees with the statement, "I have a sense of loyalty towards the establishment," on a 5-part scale from "strongly disagree" to "strongly agree", with "neither agree nor disagree" as the middle category.

Turnover Variable. The turnover variable is based on a question asked of the manager most responsible for personnel about the number of permanent employees who stopped working at the workplace in the last five years because they resigned voluntarily. The variable used in the analysis isthe turnover rate that is the number of permanent employees leaving the workplace divided by the number of permanent employees at the time of the survey.
Defining Employee Share-ownership. The ESO measure is based on the paper by Pendleton (2007) which stressed the importance of disaggregating schemes for

WERS 2004 to develop an accurate measure of ESO schemes. Four categories of ESO scheme were generated, specifically Save as you Earn Scheme (SAYE), Share Incentive Plan (SIP), CSOP and other ESO schemes (including EMI). The other schemes included EMI which was present in as few as 8 workplaces.

RESULTS

Share ownership and Commitment. Contrary to hypothesis one, the results suggest that workplaces with share ownership schemes in place do not have higher levels of commitment, other things equal. The results show that CSOP, SAYE, SIP and other schemes all have a negative but insignificant association with the levels of commitment. Therefore, irrespective of the type of ESO schemes, the presence of ESO schemes is not associated with higher levels of commitment in fact they are associated with lower commitment levels. This result holds true even when controlling for a range of factors such as establishment size, employee characteristics and workforce composition.

The lack of a strong positive association between the different types of share-ownership variables and commitment calls into question the widely-held view that share ownership has its main impact on performance via enhanced employee commitment, and the related belief that share ownership is a key component in the generation of a high commitment workplace (Long, 1978a; Pierce et al., 1991; NCEO, 2002, 2004). One possible explanation for this result builds on the theory of unmet expectations. Kruse (1984) suggests that the existence of share ownership schemes raises expectations with respect to greater participatory rights amongst the employees in these workplaces. The inability of the share ownership schemes to fulfil these expectations may result in disillusionment and hence a decline in the levels of commitment amongst employees in some share ownership establishments. Interestingly the type of ESO schemes does not have any impact upon the levels of commitment in a firm.

Share Ownership and Turnover. In support of hypothesis two, the results suggest that there is a strong negative relationship between narrow based share ownership scheme i.e. CSOP and employee turnover, other things equal. This result does not apply to the other types of ESO schemes such as SAYE, SIP and other ESO schemes. These schemes have a negative but insignificant association with employee turnover. The possibility that the lower levels of employee turnover in share ownership establishments are attributable to the high wages paid in these establishments (Renaud et al., 2004; Blair and Kruse, 1999) is tested by controlling for the proportion of full-time employees earning below £9000 pa and above £29000 pa. Neither variable is significant at the ten per cent level. The suggestion therefore is that the often found positive relationship between share ownership and performance could result from its influence on the quit-rate, by helping the firm to economise on hiring/firing costs and protecting valuable investments in specific human capital. This would suggest a “golden handcuffs” explanation of the positive share ownership/performance relationship.

Share Ownership and Performance. In order to test for hypothesis 3 and consider whether the impact of share ownership operates either in part through its impact on labour turnover, we have adopted a two stage process. This involves taking the fitted values of labour turnover from the ESO and employee turnover equations outlined above, and using these in the performance equations. In this way we are controlling for the indirect effect of share ownership on performance via its effect on turnover. The coefficients on share ownership then measure the direct or net effect on performance.

Support exists for hypothesis three based on the results of the binomial probit analysis relating to the different types of ESO schemes (CSOP, SIP, SAYE and other) on financial performance and labour productivity. The results indicate that CSOP has no significant impact upon financial performance but is associated with higher labour productivity. However, the positive effect of CSOP on labour productivity is no longer evident upon inclusion of the fitted value for employee turnover. The coefficient estimate for CSOP changes from 0.413 (significant at the 5%) to 0.367 (not significant) upon the inclusion of the fitted value for employee turnover in the equation on CSOP and labour productivity. This suggests that a significant part of the positive relationship between share ownership and labour productivity is due to the impact of share ownership on labour turnover, thereby offering strong support for the golden handcuff thesis. Thus, the higher levels of labour productivity observed in share ownership workplaces specifically workplaces with CSOP are attributable to lower levels of employee turnover, thereby providing strong support for the golden handcuff hypothesis. These results hold true even when controlling for different types of ESO schemes and a range of establishment and sectoral controls. Interestingly, significant results are not evident in case of SAYE, SIP or other types of ESO schemes.

Finally, the different performance outcomes for difference types of employee share ownership schemes lends support to Hypothesis 4 which predicts that narrow based and broad based stock option schemes have differing impacts upon performance. This finding suggests that the type of ESO scheme has an impact upon the ESO performance relationship. Furthermore, positive and significant outcomes are evident only for CSOP and this provides support for the study by Fernie and Metcalf (1995) where they observed benefits in terms of higher performance and lower employee turnover only in case of executive share option schemes but not for SAYE schemes. This finding further contributes to advancing the ongoing debate about the relative effects of broad based schemes versus narrow based schemes, the relative importance of the value of the individual shareholdings versus the proportion of employees owning shares as well as the occupational distribution of schemes based on managerial and non-managerial employees.

DISCUSSION AND CONCLUSIONS

The findings in this paper contribute to the academic debate on ESO and performance in a number of ways. First, it challenges conventional wisdom by suggesting that ESO schemes impact upon performance by acting as an effective retention tool by making it more lucrative for employees to remain with the firm rather than by fostering higher levels of commitment amongst the employees. This conclusion is based on an analysis which uses a strict definition of ESO schemes and thus further validates the findings from the previous research using the WERS 98 dataset (Sengupta et al. 2007). Second, by advocating the 'golden handcuff' theory, this paper emphasises the critical role played by financial considerations and therefore continuance rather than affective commitment in explaining the higher productivity in share ownership firms. Therefore, this paper makes a case for distinguishing between different components of commitment when attempting to explain the ESO/performance relationship. Third, the finding that higher performance and lower turnover benefits are evident only for certain types of narrow based ESO scheme such as CSOPs and not for broad based ESO schemes such as SAYE, SIP and other types of ESO schemes suggests that the type of ESO schemes plays a critical role in determining the performance outcomes in ESO firms. It also provides support for the need to recognise the heterogeneity of ESO schemes in any future research on ESO/performance.

The findings also have implications for managerial practitioners and companies considering the implementation of a share scheme. The results would enable them to have a more realistic view of the expected benefits and the costs associated with the adoption of a share scheme, thereby influencing their decision on whether to invest in a share scheme and inform their decisions on the type of scheme they may want to introduce. Furthermore, managers will view it as a useful retention and recruitment device rather than a motivational tool. The findings have implications for policy-makers who determine the incentives that should be given to encourage companies to adopt share ownership schemes. When the mere existence of share schemes is no guarantee for boosting organisational performance, bringing about a more equitable distribution of wealth, policy-makers may wish to reconsider whether or not to encourage their adoption or to advocate tax breaks.

Some caution must, however, be applied to the conclusions reached in this study. This particularly applies to the cross–sectional nature of the data-set and the potential for reverse causality especially regarding financial performance. The problem of causality can be addressed by using panel data, or by designing longitudinal studies with different samples. Qualitative data could add value by providing insights into the causal processes. A case is thereby made for encouraging a tradition of collaborative research employing both quantitative and qualitative analysis techniques.

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